Supreme Court, U.S.
FILED

No. 94-618 OCT - 5 1994

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In The

Supreme Court of the United States

October Term, 1994

STATE OF IOWA, TERRY E. BRANSTAD, and
IOWA FRANCHISEE ASSOCIATION,

Petitioners,

v.

HOLIDAY INNS FRANCHISING, INC.,
HOLIDAY INNS, INC., and
MCDONALD'S CORPORATION,

Respondents.

**Joint Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eighth Circuit**

PETITION FOR WRIT OF CERTIORARI

BONNIE CAMPBELL
Attorney General of Iowa

GORDON E. ALLEN*
Deputy Attorney General

MARK HUNACEK
Assistant Attorney General
Office of the Attorney General
Second Floor
Hoover State Office Bldg.
Des Moines, Iowa 50319
(515) 281-5166
FAX (515) 281-4209

Counsel for Petitioners, State of Iowa and Terry E. Branstad

BRENT R. APPEL*
DICKINSON, MACKAMAN, TYLER & HAGEN
A Professional Corporation
1600 Hub Tower
699 Walnut Street
Des Moines, IA 50309
(515) 244-2600
FAX (515) 246-4550

Counsel for Petitioner Iowa Franchisee Association

*Counsel of Record

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Whether a state franchising statute prohibiting unfair or abusive practices by franchisors should be held invalid under the Contract Clause of the United States Constitution when applied to franchisor-franchisee agreements in effect at the time of the statute's effective date in the absence of any discussion of the public purposes served by the statute.

2. Whether the public purpose of prohibiting unfair or abusive practices by franchisors is a significant and legitimate public purpose under the Contract Clause which justifies contractual impairments, substantial or otherwise, caused by specific provisions of a state franchising statute regulating termination, transfer, nonrenewal, and encroachment.

3. Whether specific provisions of a state franchising statute regulating unfair or abusive practices of franchisors in termination, transfer, nonrenewal, and encroachment can be invalidated under the Contract Clause in the absence of any consideration of the precise nature of the contractual rights in question and the extent to which those rights have been impaired.

4. Whether a substantial contractual impairment under the Contract Clause can be established based on provisions of a state statute regulating unfair or abusive practices of franchisors in termination, transfer, nonrenewal, and encroachment where certain of those statutory provisions are virtually identical to state common law and where there is a rich history of regulatory, common law, and business concern over those same unfair and abusive practices that the statute is designed to regulate.

PARTIES TO PROCEEDINGS

Petitioners are the State of Iowa, Terry E. Branstad, Governor of the State of Iowa, and the Iowa Franchisee Association.

Respondents are Holiday Inns Franchising, Inc., Holiday Inns, Inc., and McDonald's Corporation.

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**Joint Petition For Writ Of Certiorari
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PETITION FOR WRIT OF CERTIORARI

Petitioners the State of Iowa, Terry E. Branstad, and the Iowa Franchisee Association respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered on July 7, 1994.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit is reported at 29 F.3d 383 (8th Cir.

1994). A copy of that opinion is included in the Appendix as Exhibit A.

The District Court decision affirmed by the Eighth Circuit is reported at 822 F. Supp. 597 (S.D. Iowa 1993). A copy of that opinion is included in the Appendix as Exhibit B.

JURISDICTION

Jurisdiction in this case is premised upon 28 U.S.C. § 1254(1) for review by certiorari of the judgment and opinion of the United States Court of Appeals for the Eighth Circuit. A written opinion was issued by that Court on July 7, 1994.

Jurisdiction in the District Court was based on 28 U.S.C. §§ 1331, 1367, and 2201. Jurisdiction in the Eighth Circuit Court of Appeals was based on 28 U.S.C. § 1292(b). The District Court, on its own motion, determined that this case was one which involved a controlling question of law as to which there is substantial ground for difference of opinion and certified an immediate appeal from the adjudication of the litigation. *McDonald's Corp. v. Nelson*, 822 F. Supp. 597, 609 (S.D. Iowa 1993) (App. 34). The Eighth Circuit then granted petitioners' request for interlocutory appeal.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional provision involved is the Contracts Clause of the United States Constitution, U.S. Const. art. 1, § 10, cl. 1: "No state shall . . . pass any . . . Law impairing the Obligation of Contracts. . . . " Plaintiff McDonald's Complaint for Declaratory Judgment filed with the federal district court specifically noted that all claims arising under the Constitution and laws of the State of Iowa involve the same nucleus of operative facts and are supplemental to the federal claims. The language of the Iowa Contract Clause, Iowa Const. art. 1, § 21 ("No . . . law impairing the obligation of contracts, shall ever be passed."), and the analysis employed in assesing the constitutionality of statutes under it are substantially the same as the language of and analysis under the federal Contract Clause. *McDonald's Corp.*, 822 F. Supp. at 605, *citing Adair Benev. Soc. v. State Ins. Div.*, 489 N.W.2d 1, 5 (Iowa 1992) (App. 25). The district court and the Eighth Circuit ruled the challenged provisions of the Iowa Franchise Act unconstitutional under both the federal and state Constitutions, placing exclusive reliance upon federal authorities.

Relevant portions of the state statute at issue, the Iowa Franchise Act (Iowa Code Chapter 523H), are set forth in the Appendix as Exhibit C.

STATEMENT OF THE CASE

The day after the enactment of Iowa Code Chapter 523H, the Iowa Franchise Act, respondents, Holiday Inns

Franchising, Inc. and Holiday Inns, Inc., brought an action in federal district court challenging its constitutionality. Iowa Governor Terry E. Branstad was named as a defendant in that action, as were several franchisees of the plaintiffs [respondents here]. In a separate action, respondent McDonald's Corporation brought suit against two of its franchisees, also alleging that Chapter 523H was constitutionally infirm. The State of Iowa, though not named as a defendant in that action, received permission from the court to intervene as a defendant. In addition, the Iowa Franchisee Association sought and obtained permission to intervene as a defendant in both actions.

The Iowa Franchise Act, which became effective on July 1, 1992, contains a number of provisions governing activities of franchisors and franchisees in an effort to avoid certain conduct found by the legislature to be abusive or unfair. The four aspects of the statute that are pertinent to this appeal involve termination, nonrenewal, encroachment and transfer of a franchise. For example, the statute allows a franchisor to terminate a franchise or to refuse to renew a franchise, subject to "good cause" and notice. Iowa Code § 523H.7. The statute also requires that prior to establishing a new outlet within unreasonable proximity of an existing franchise, the franchisor must give the existing franchisee a right of first refusal or a right to compensation for market share diverted by the new outlet. Iowa Code § 523H.6. It is undisputed that the statute, by its terms, applies to existing franchise agreements as well as to agreements entered into after the effective date of the Act. Iowa Code § 523H.2.

The plaintiffs in both cases moved for partial summary judgment, contending that the application of designated provisions of the Act to existing franchise agreements violated the Contract Clause of the United States Constitution as well as the Contract Clause of the Iowa Constitution. All petitioners resisted the motions and the State of Iowa and Governor Branstad cross-moved for summary judgment. While these cases have not been consolidated for purposes of trial of the remaining issues, the district court considered the partial motions for summary judgment and cross-motions together and entered one consolidated order.

The district court concluded that the application of challenged provisions of the Act[1] to existing contracts violated the Contract Clause and granted plaintiffs' motions for partial summary judgment. *McDonald's Corp. v. Nelson*, 822 F. Supp. 597, 609 (S.D. Iowa 1993). (App. 34-35.) The district court, on its own motion, certified this case for immediate appeal pursuant to 28 U.S.C. § 1292(b). The Eighth Circuit Court of Appeals granted petitioners' petition for permission to appeal and on appeal affirmed the decision of the district court.

Significantly, in affirming the district court the Eighth Circuit did not address at all the public purpose served by the Act. Instead, the Court began and ended its analysis with the observation that the Act substantially

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[1] Iowa Code § 523H.5(1), (4), (5), (13)(d), (13)(e), (13)(g), addressing transfers of franchises; § 523H.6, addressing encroachment; § 523H.7, addressing termination of franchise agreements; and § 523H.8, addressing renewals of franchise agreements.

impaired existing contracts. Repeated language in the opinion suggests that the Court believed that any substantial impairment of a contract was unconstitutional. The Court referred in the first paragraph of its opinion to plaintiffs' belief that the Act "substantially *and thus* unconstitutionally" impaired the obligation of a contractor, *Holiday Inns Franchising, Inc. v. Branstad*, 29 F.3d 383, 384 (8th Cir. 1994) (App. 4), and later in the opinion the Court stated that "in determining whether an impairment is substantial, *and thus* unconstitutional. . . . " *Id.* (App. 4) (Emphasis added.) The decision of the Eighth Circuit clearly implies that any legislation which substantially impairs a contract is void, regardless of the severity of the harms sought to be corrected by the statute.

The Eighth Circuit's decision is also devoid of any analysis regarding the alleged substantial impairments. Rather, the Court simply acquiesced in the findings and conclusions of the district court, *Holiday Inns*, 29 F.3d at 384 (App. 4), a decision which, itself, fails to analyze the precise nature of the contractual rights in question. Rather, the district court simply outlined the provisions of the contracts in question and set forth the asserted expectations of plaintiffs when entering into those contracts. At no time did the district court examine the precise contractual terms in light of statutory language, regulatory history, or other matters relevant to Contract Clause review. The district court concluded that contractual expectations of the parties at the time of execution of these agreements had been materially altered by the statute – a conclusion flowing from a facial comparison of statutory terms with plaintiffs' statements of what they expected the contracts to do. In seemingly accepting this

analytical approach, the Eighth Circuit has departed from established Contract Clause analysis and in its place has essentially held that any impairment of an existing contract that facially alters the asserted expectations of a party to that contract constitutes a substantial impairment.

REASONS FOR GRANTING THE WRIT

The essential requirements of Contract Clause analysis look to the precise nature of the contractual right and asserted statutory impairment and, if substantial impairment is found, to the public purpose supporting the statute. Both prongs of Contract Clause evaluation are critical; neither prong is optional. Complete failure by the Eighth Circuit Court of Appeals to address the public purposes behind the state's statutory scheme is a serious flaw that, if allowed to stand, irrefutably alters a major component of Contract Clause analysis contrary to long-established principles of constitutional law adhered to by this Court, the federal courts of appeal, and state courts of last resort and, further, leaves no room for state legislative discretion in addressing policy issues of any sort where existing contracts might be impacted. Similarly, failure to appropriately analyze the precise provisions of the contracts in question in light of statutory language, legislative history, and other recognized factors of review upsets the critical balance of interests long-established in Contract Clause jurisprudence, thereby diverting appropriate inquiry from essential issues of contractual impairment to an immediate evaluation of the wisdom and acceptability of a state statute. Adherence to the required

prongs of Contract Clause analysis in this case would establish that no constitutional impairment exists and, further, that the provisions of Iowa's Franchise Act are amply supported by significant and legitimate public policy considerations.

I. THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS, INVALIDATING THE APPLICATION OF THE IOWA FRANCHISE ACT TO EXISTING AGREEMENTS WITHOUT EVEN CONSIDERING THE PUBLIC PURPOSES SERVED BY THE ACT, CONFLICTS WITH CONTRACT CLAUSE DECISIONS OF THIS COURT, OTHER FEDERAL COURTS OF APPEAL, AND STATE COURTS OF LAST RESORT ON AN ISSUE OF NATIONAL IMPORTANCE.

In any case in which it is alleged that a state law violates the Contract Clause, the first inquiry is whether the law has, in fact, operated as a substantial impairment of a contractual relationship. *Energy Reserve Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 411 (1983). If a substantial impairment is found, the inquiry is not over. Instead, the court looks to whether there is a significant and legitimate public purpose behind the law. *Id.* One such public purpose is "the remedying of a broad and general social or economic problem." *Id.* at 412. The public purpose need not be addressed to an emergency or temporary situation. Finally, once a legitimate public purpose has been identified, the question becomes whether the adjustment of "the rights and responsibilities of contracting parties [is based] upon reasonable conditions and

[is] of a character appropriate to the public purpose justifying [the legislation's] adoption." *Id.* Unless the state is itself a contracting party (which it is not in this case), "courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure". *Id.* at 413.

In this case, the Eighth Circuit first considered the question of substantial impairment, and, having found substantial impairment, apparently concluded *on that basis alone* that the Iowa Franchise Act was unconstitutional. *Holiday Inns*, 29 F.3d at 384 (App. 4). By failing to even consider the public purpose of the Act (which has been extensively discussed by courts and commentators for decades), the Eighth Circuit failed to apply the legal standard mandated by this Court.

The use of the incorrect legal standard in this case has implications far beyond the franchising context. By substantially weakening the test to be applied in Contract Clause analysis, the Eighth Circuit has correspondingly weakened the ability of states to pass remedial legislation of any nature. At the very least, the Eighth Circuit has in essence adopted a form of "strict scrutiny" for any legislation which substantially impairs an existing contract, and, at most, the court has adopted an absolute prohibition against substantial impairments regardless of the necessity for that legislation.

This Court has repeatedly and unequivocally stated that while the language of the Contract Clause is facially absolute, its prohibitions must be weighed against the state's interest in protecting the public from social and economic harm. *Energy Reserves*, 459 U.S. at 410. The

decision of the Eighth Circuit, which improperly ignores the public purpose to be served by the Act, conflicts with the decisions of this Court as well as the decisions of any lower court which properly applies the three-part Contract Clause standard. That conflict carries with it attendant consequences impacting the ability of a legislature to pass remedial legislation.

II. THE PUBLIC PURPOSE OF PROHIBITING UNFAIR OR ABUSIVE PRACTICES BY FRANCHISORS IS A SIGNIFICANT AND LEGITIMATE PUBLIC PURPOSE UNDER THE CONTRACT CLAUSE WHICH JUSTIFIES IMPAIRMENTS, SUBSTANTIAL OR OTHERWISE, TO EXISTING CONTRACTS UNDER PROVISIONS OF THE IOWA FRANCHISE ACT REGULATING TERMINATION, TRANSFER, NONRENEWAL, AND ENCROACHMENT.

It is certainly no exaggeration to say that franchising is a pervasive method of doing business in America today. It is a method of doing business that touches on food supply, accommodations, automobile dealerships and a host of other activities.

Franchising is also an endeavor which, by virtue of the unique relationship between the franchisor and franchisee, results in built-in inequalities and potential for abuse. Rau, *Implied Obligations in Franchising: Beyond Terminations*, 47 Bus. Lawyer 1053, 1053 (1992); Comment, *Franchise Termination and Nonrenewal*, 26 S.D. L. Rev. 321, 322 (1981); Note, *Constitutional Obstacles to State "Good Cause" Restrictions on Franchise Terminations*, 74 Columbia L. Rev. 1487, 1487-88 (1974). This potential for abuse is

not just conjectural. Indeed, the Eighth Circuit Court of Appeals has itself pointed out that the literature of franchising law "is strewn with reports of sophisticated and financially powerful franchisors taking advantage of relatively inexperienced franchisees". *Modern Computer Systems v. Modern Banking Systems*, 871 F.2d 734, 739 (8th Cir. 1989).

Such abuses are part of the summary judgment record in this case. The Iowa legislature, prior to passing the Act, convened the Franchise Regulation Interim Study Committee which heard a number of specific instances of abusive and unfair practices. In addition, as the district court noted, "others who wanted to appear and present statements did not out of fear of repercussions by their franchisors." *McDonald's*, 822 F. Supp. at 608 n.9 (App. 32).

The potential for abuse, and the actual abuses that have occurred, has led to the passage of legislation on both the federal and state level concerning franchise relationships of one form or another. "The onslaught of lawsuits in this area has not gone unnoticed by legislatures. Almost every state has made at least one attempt of regulating the franchise method of doing business." Greco, *Adjusting the Equities in Franchise Termination: A Sui Generis Approach*, 30 Cleveland St. L. Rev. 523, 524 (1981). While some of these statutes have been limited to particular kinds of franchises (for example motor vehicle franchises), a number have been of the "general franchise regulation" type. Various franchise laws across the country are indexed and discussed in Peigoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 Bus. Lawyer 289 (1989). This summary shows that "good cause"

requirements, as well as encroachment and transfer provisions, are not unique to the Iowa Act. The author also points out that other states have encroachment and transfer provisions. *Id.* at 329-330. A number of courts, including the Eighth Circuit, have spoken with approval of the public purposes motivating such legislation. *Bain v. Champlin Petroleum Co.*, 692 F.2d 43, 48 (8th Cir. 1982); *Arnott v. American Oil Co.*, 609 F.2d 873, 882-883 (8th Cir. 1979); *Boatland, Inc. v. Brunswick Corp.*, 558 F.2d 818, 823 (6th Cir. 1977); *Westfield Centre Service, Inc. v. Cities Service Oil Co.*, 86 N.J. 453, 432 A.2d 48, 53 (1981).

In another reflection on the important public policy purposes served by legislation such as the Act, other courts have adopted common law rules restricting the rights of franchisors to engage in completely arbitrary conduct towards franchisees. One court, for example, noted that in cases of franchise termination, "courts have refused to give literal effect to the language of the franchise agreement." *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*, 732 F.2d 480, 485 (5th Cir. 1984). Other illustrative cases include *Larese v. Creamland Dairies, Inc.*, 767 F.2d 716, 717 (10th Cir. 1985); *Schneck v. Burger King Corp.*, 756 F. Supp. 543 (S.D.Fla. 1991) *motion to reconsider denied*, 759 F. Supp. 692 (S.D.Fla. 1992); *Shell Oil Co. v. Marinello*, 294 A.2d (N.J.Super.Ct. 1972), *modified*, 307 A.2d 598 (N.J. 1973), *cert. denied*, 415 U.S. 920 (1974).

Proper application of the appropriate legal standard should result in validation of the Act. There is clearly a public purpose involved here, and the Act is rationally related to it, so that the second and third prongs of the legal standard are satisfied. Moreover, the Act applies to all franchisors and does not single out any one particular

franchisor for special treatment. It is those kinds of statutes – those that directly repudiate a specific contract – that are really the ones that the Contract Clause is designed to invalidate. *See, e.g., Energy Reserves,* 459 U.S. at 417 n.25, which distinguishes a constitutionally infirm statute as being one where "a small number of employers were singled out from the larger group." This "favoritism" to a subgroup of a regulated group is what constitutes prohibited "special interest legislation," not the existence of regulation in the first place, and this favoritism is totally absent in the present case.

The decision of the Eighth Circuit conflicts with decisions of other federal courts of appeal which have upheld the retroactive application of legislation affecting existing contracts based on the existence of a public interest. *See e.g., Troy Ltd. v. Renna,* 727 F.2d 287 (3rd Cir. 1984) (upholding the Senior Citizens and Disabled Protected Tenancy Act, which restricted the rights of landlords to evict certain tenants). More specifically, the decision of the Eighth Circuit conflicts with other decisions which uphold retroactive application of laws affecting a franchisor-franchisee relationship. Such cases include *Schieffelin & Co. v. Dep't of Liquor Control,* 479 A.2d 1191 (Conn. 1984); *Anderson's Vehicle Sales, Inc. v. OMC-Lincoln,* 287 N.W.2d 247 (Mich. 1979). Conflicting decisions among federal courts and state courts of last resort on issues of constitutional dimension and impacting upon policy matters of national importance merit review of this matter by this Court.

III. THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS, INVALIDATING THE APPLICATION OF SPECIFIC PROVISIONS OF THE IOWA FRANCHISE ACT TO EXISTING AGREEMENTS ABSENT ANY CONSIDERATION OF THE PRECISE NATURE OF THE CONTRACTUAL RIGHTS INVOLVED AND THE EXTENT TO WHICH THOSE RIGHTS HAD BEEN IMPAIRED, IS CONTRARY TO DECISIONS OF THIS COURT AND INAPPROPRIATELY INVADES THE PROVINCE OF THE STATE LEGISLATURE.

Contract Clause analysis developed by this Court first asks the threshold question of "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." *Energy Reserves*, 459 U.S. at 411. *See also General Motors Group v. Romein*, ___U.S.___, 112 S.Ct. 1105, 1109, 117 L.Ed.2d 328 (1992) ("Generally, we first ask whether the change in state law has 'operated as a substantial impairment of a contractual relationship'.") This Court has made it abundantly clear that an answer to this question begins with an identification of the *precise* contractual right that has been impaired and the nature of the statutory impairment. *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 502 (1987).

The *Keystone* requirement is an essential element of Contract Clause analysis that cannot be taken lightly no matter how onerous is the task of examining contractual provisions, assessing the precise rights that have been impaired, and identifying the nature of the statutory impairment. This requirement is in keeping with the long-held principle of constitutional law that "a statute does not violate the Contract Clause simply because it

affects, or even totally bars, the performance of contractual obligations entered into before its enactment date." *Exxon Corp. v. Eagerton*, 462 U.S. 176, 190 (1983). Legislative judgment in safeguarding the vital interests of the public should not be interfered with if the right purportedly impaired is one that falls outside the scope of Contract Clause protection or otherwise has not been substantially impaired by the state's statutory scheme. *Id.*

The need to address this threshold question has been reaffirmed in *General Motors*, 112 S.Ct. at 1109-1110, where this Court reaffirmed that Contract Clause analysis begins by asking whether a change in state law has "operated as a substantial impairment of a contractual relationship." This inquiry has three components: 1) whether there is a contractual relationship, 2) whether a change in law impairs that contractual relationship, and 3) whether the impairment is substantial. *Id.* The language focus on *relationship* cannot be used, however, to abandon the need to discern the precise nature of the contractual *right* involved in favor of tempting and exclusive reliance upon the expectations of the parties in determining whether a substantial impairment of a contractual *right* has occurred. This Court in *General Motors*, just like the Court in earlier Contract Clause cases, engaged in a significant evaluation of the contracts in question, their terms, the rights involved, and the extent, if any, to which such rights had been impaired. No less should have occurred here.

The Eighth Circuit's discussion of the substantial impairment issue consisted of little more than a reference to the opinion of the federal district court. *Holiday Inns*, 29 F.3d at 384 ("We do not think that it can be seriously

contested that the retroactive feature of the relevant Iowa legislation substantially impaired the obligations previously owed to the plaintiffs in this case. . . . We therefore do not see that any useful purpose would be served by a re-examination of the applicable legal principles so ably canvassed and applied by the district court.") The district court did, indeed, "canvass" or set forth certain Contract Clause principles and, further, outlined certain aspects of the contracts involved, but that court failed to analyze specific contractual provisions in light of statutory language, the historical regulation of franchising activities, enunciated principles of Iowa common law, or ethical principles of the franchising industry to determine the *precise* nature of the contractual rights involved and whether those rights had, in fact, been substantially impaired. Rather, the district court relied upon the assertions of disappointed expectations of the plaintiffs and concluded from there that contractual rights had been materially altered by the Iowa Franchise Act. *McDonald's Corp.*, 822 F. Supp. at 606.

The Eighth Circuit seemingly accepted the district court's facial conclusions. The decision of the Eighth Circuit, itself, contains no analysis of whether and to what extent the franchisors would, or even want to, engage in conduct allowed by their contracts but prohibited by the Act. By way of example, the Act does not totally restrict the ability of franchisors to terminate or refuse to renew franchise agreements; franchisors can still engage in these acts if good cause exists to do so. Iowa Code §§ 523H.7,.8. A state law that does not totally negate a contractual provision, or one that replaces the provision with a comparable one, does not necessarily substantially impair the

contract. This Court noted as much in *United States Trust Co. v. New Jersey*, 431 U.S. 1, 19 (1977), where, pointing out that a particular law did substantially impair a contract, the Court specifically stated: "nor was the covenant merely modified or replaced by an arguably comparable security provision. Its outright repeal totally eliminated an important security provision and thus impaired the obligation of the State's contract."

Under this Court's analysis, then, a plaintiff in a Contract Clause case is required to demonstrate the extent to which a state law modified its rights under an existing contract. For example, Holiday Inns and McDonald's should be required to demonstrate the extent to which they frequently seek to terminate or refuse to renew a franchise without good cause. Not only have McDonald's and Holiday Inns not provided any such evidence, they have not even alleged that prior to the passage of the Act they were planning to either terminate or refuse to renew the franchise agreements with the franchisee defendants.

The approach to assessment of "substantial impairment" advocated here is consistent with that adopted by the court in *General Offshore Corp. v. Farrelly*, 743 F. Supp. 1177 (D. Virgin Islands 1990), a case involving a statute which limited the right of an employer to fire an employee. The court there noted that while a statute absolutely prohibiting discharge would work a substantial impairment of contract, the statute in that case provided a list of circumstances under which an employer could discharge an employee, and went on to state that the "plaintiff has not given a single legitimate reason for which an employer might wish to fire an employee that is

not covered by the statute, and this Court can think of no significant ones." *Id.* at 1198-99. The court thus engaged in an "incremental" analysis such as is urged here. Because the plaintiff in *General Offshore* could not show that it wished to terminate employees under conditions not specified by the statute, it failed to convince the court that the statute worked a substantial impairment.

The Eighth Circuit approach, finding substantial impairment in the total absence of any such kind of analysis, results in a situation whereby any contractual alteration will, by virtue of that fact alone, be considered substantial "and thus unconstitutional." As previously noted, such an approach has the immediate and unfortunate effect of drastically reducing the ability of a state to pass any sort of remedial legislation that touches upon any abusive or unfair practices that happen to be incorporated into an agreement between two parties regardless of the relative bargaining strength of the parties involved.

Concern on this point is neither academic nor limited to the case at hand. This Court has remained faithful to its threshold requirement that an analysis of the contractual rights involved must occur. *E.g., General Motors,* 112 S.Ct. at 1109-10; *Keystone,* 480 U.S. at 504; *Exxon,* 462 U.S. at 190-94. Legislative enactments are presumed constitutional. Analysis of the impact of challenged statutes upon an existing contract further accords deference to the state's determination of its own policies. In the end, an appropriate evaluation of contractual terms in accordance with Contract Clause principles is essential to maintaining the long-established balance of constitutional rights and states' interests inherent in this analysis.

IV. PROVISIONS OF IOWA'S FRANCHISE ACT GOVERNING TERMINATION, TRANSFER, NONRENEWAL, AND ENCROACHMENT DO NOT SUBSTANTIALLY IMPAIR RIGHTS AND OBLIGATIONS IN EXISTING CONTRACTS SINCE CERTAIN OF THOSE STATUTORY PROVISIONS ARE VIRTUALLY IDENTICAL TO STATE COMMON LAW AND THERE EXISTS A RICH HISTORY OF REGULATORY, COMMON LAW, AND BUSINESS CONCERN OVER THE UNFAIR AND ABUSIVE PRACTICES THE ACT IS DESIGNED TO REGULATE.

This Court has noted that the history of past regulation is a factor that can be relevant in determining whether an alleged impairment is substantial. *Energy Reserves*, 459 U.S. at 411. No party to the lawsuit disputes the fact that the greater the extent of prior regulation in the area that is the subject of the statute, the less likely it is that substantial impairment of an existing contract will be found. In the present case, the existence of franchise legislation in Iowa and in other states, as well as proposed legislation and scholarly commentary over the past few decades calling for legislation, would suggest to a reasonable franchisor that legislation was likely.

Plaintiffs cannot realistically claim to be unaware of the extensive debate raging in the law books and journals over the propriety of enforcement of contractual provisions such as are at issue here. The court in *Schieffelin & Co. v. Dep't of Liquor*, 479 A.2d 1191 (Conn. 1984) found this to be a relevant consideration in determining the extent to which the area of the contract had been previously regulated. "Nor could they have been unaware of the social and economic problems caused by sudden

termination of franchises. During the early 1970's, for example, just cause termination provisions were included in a variety of franchising statutes in Connecticut." *Id.*, 479 A.2d at 1200-1201. Plaintiffs cannot reasonably argue that they were unaware of the possibility of state regulation in an area fraught with the possibility of abuse where these abuses had been the subject of vigorous prior discussion.

In fact, the termination provisions of Holiday Inns' agreements contain language making those agreements subject to applicable local law. The fact that local law is incorporated in the agreements reflects an awareness of the possibility of regulation. *Energy Reserves*, 459 U.S. at 416. Such awareness is further highlighted by established state common law provisions which were essentially codified by the Act, *see Midwest Management Corp. v. Stephens*, 291 N.W.2d 896, 913 (Iowa 1980) (requiring terminaton of subscription agreement based on good faith and fair dealing), as well as the marked similarity of applicable provisions of the Act to the Code of Ethics approved by the International Franchise Association. By way of example, Iowa Code § 523H.8 requires notice and good cause prior to a refusal to renew a franchise in much the same way that ethical principles of that Association require notice and good cause. *See Franchise Self-Regulation*, CCH Business Franchise Guide, No. 156 (Dec. 18, 1992) at 12.

Appropriate examination of identified contractual rights in light of the above would reveal that impairments, if any, caused by the Act were minimal at best. While different reasons would support this finding depending upon the contractual right alleged and the applicable statutory provison, in the end the Iowa Franchise Act

withstands constitutional scrutiny under Contract Clause analysis unequivocably adhered to by this Court.

CONCLUSION

For all of the above reasons, the State of Iowa, Terry E. Branstad, and the Iowa Franchisee Association respectfully request that their Joint Petition for Writ of Certiorari be granted.

BONNIE J. CAMPBELL
Attorney General of Iowa

GORDON E. ALLEN*
Deputy Attorney General

MARK HUNACEK
Assistant Attorney General
Office of the Attorney General
Second Floor
Hoover State Office Bldg.
Des Moines, Iowa 50319
(515) 281-5166
FAX (515) 281-4209

Counsel for Petitioners, State of Iowa and Terry E. Branstad

BRENT R. APPEL*
DICKINSON, MACKAMAN, TYLER & HAGEN
A Professional Corporation
1600 Hub Tower
699 Walnut Street
Des Moines, Iowa 50309
(515) 244-2600
FAX (515) 246-4550

Counsel for Petitioner, Iowa Franchisee Association

*Counsel of Record

EXHIBIT A

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 93-2606

Holiday Inns Franchising, Inc., and Holiday Inns, Inc.,

Appellees,

v.

Terry Branstad, Governor of the State of Iowa,

Appellant,

John Q. Hammons and Omaha Hotel, Inc.,

Defendants,

Iowa Franchisee Association,

Intervenor.

Appeals from the United States District Court for the Southern District of Iowa.

No. 93-2607

McDonald's Corporation,

Appellee,

v.

Steven Nelson and Tass Enterprises, Inc.,

Defendants,

State of Iowa,

Appellant,

Iowa Franchisee Association,

Intervenor.

No. 93-2609

McDonald's Corporation,

Appellee,

v.

Steven Nelson and Tass Enterprises, Inc.,

Defendants,

State of Iowa,

Intervenor,

Iowa Franchisee Association,

Appellant.

Holiday Inns Franchising, Inc., and Holiday Inns, Inc.,

Appellees,

v.

Terry Branstad, Governor of the State of Iowa; John Q. Hammons and Omaha Hotel, Inc.,

Defendants,

Iowa Franchisee Association,

Appellant.

Submitted: January 12, 1994

Filed: July 7, 1994

Before BEAM and MORRIS SHEPPARD ARNOLD, Circuit Judges, and STROM,* District Judge.

MORRIS SHEPPARD ARNOLD, Circuit Judge.

These were consolidated actions for summary judgment claiming that application of the Iowa Franchise Act, *see* Iowa Code Ann. §§ 523H.1-523H.17, to existing franchise agreements was unconstitutional under the Contract Clause of both the United States and Iowa Constitutions. Section 2 of the Act expressly extends its effects to existing franchise arrangements. Plaintiffs

* The HONORABLE LYLE E. STROM, Chief Judge, United States District Court for the District of Nebraska, sitting by designation.

pointed to several provisions of the Act that they believed would substantially and thus unconstitutionally impair the obligations owed by their franchisees under their current licensing arrangements. Those provisions concern principally the circumstances under which franchisees can transfer their franchises without the franchisor's consent and the right of the franchisor to terminate or refuse to renew the agreement. The district court, in a detailed and well-considered opinion, held that the retroactive application of these provisions violated both the Iowa and United States Constitutions. This appeal resulted. We affirm the district court.[1]

I.

We do not think that it can be seriously contested that the retroactive feature of the relevant Iowa legislation substantially impaired the obligations previously owed to the plaintiffs in this case, or that this dispute is ripe for adjudication. We therefore do not see that any useful purpose would be served by a re-examination of the applicable legal principles so ably canvassed and applied by the district court.

We do offer, however, some observations on a very troublesome aspect of current Contract-Clause jurisprudence. The Supreme Court has held that in determining whether an impairment is substantial, and thus unconstitutional, a court should take into account whether the kind of contract or relationship that furnishes the subject

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[1] The Honorable Harold D. Vietor, United States District Judge for the Southern District of Iowa.

matter of the dispute had previously been the subject of regulation. In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 250 (1978), for instance, the Court said that the relevant inquiry was whether the disputed legislation operated "in an area already subject to state regulation at the time the company's contractual obligations were originally undertaken," or whether, instead, it "invaded an area never before subject to regulation by the State." A later case states the matter a little differently and, perhaps, more narrowly. In *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 411 (1983), the Court indicated that the proper consideration was "whether the industry the complaining party has entered has been regulated in the past." The idea, evidently, is that if the party to the contract who is complaining could have seen it coming, it cannot claim that its expectations were disappointed. To put it in economic terms, a party's evaluation of the possibility of interference is reflected in the negotiated price, and thus the value of performance to it is not reduced, if it can more or less accurately value the risk of that interference. We believe that this is the principle that the Supreme Court is developing in its cases.

We also believe that the appellees here cannot reasonably be said to have had a fair and appreciable warning of an impending intervention into their agreements. It is true, as appellants point out, that other franchise arrangements of at least five different varieties had been regulated previously in Iowa. But what appellants fail to note is that only one of those statutes purported to be retroactive and then not generally so: Its retrospective effect was limited to franchise agreements that had an

indefinite term. *See* Iowa Code Ann. §§ 322F.1-322F.9. The other such statutes either contain no reference to retroactivity or contain express provisions limiting them to prospective application only. (For an example of the latter type, *see* Iowa Code Ann. §§ 323.1-323.14.) Appellants also cite to a plethora of statutes from other jurisdictions that they claim are similar to the one under consideration here. The infirmity in this argument is that almost none of those statutes purports to be retrospective. It is absolutely plain, moreover, that the retrospective application of statutes similar to the one here, and in the circumstances that are present in this case, has almost uniformly been held unconstitutional, and this is a datum on which franchisors are presumably allowed to rely while bargaining and in fixing the prices of their licenses. *See, e.g., Northshore Cycles, Inc. v. Yamaha Motor Corp., U.S.A.*, 919 F.2d 1041 (5th Cir. 1990) (*per curiam*), and *Morgan v. Kemper Insurance Companies*, 754 F.2d 145 (4th Cir. 1985).

We therefore see no merit in appellants' argument that the plaintiffs are chargeable with notice of a reasonable possibility that the legislature would enact Iowa Code Ann. §§ 523H.1-523H.17 and make those sections retroactively applicable to existing franchise contracts.

II.

We therefore affirm the district court.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

EXHIBIT B

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

McDONALD'S CORPORATION, Plaintiff, v. STEVEN L. NELSON and TASS ENTERPRISES, INC., Defendants, STATE OF IOWA, Intervenor, IOWA FRANCHISEE ASSOCIATION, Intervenor.	*	CIVIL NO. 4-92-70301 MEMORANDUM OPINION, RULINGS, ADJUDICATION, AND § 1292(b) CERTIFICATION (Filed May 14, 1993)

HOLIDAY INNS FRANCHISING, INC., and HOLIDAY INNS, INC., Plaintiffs, v. TERRY BRANSTAD, JOHN Q. HAMMONS, and OMAHA HOTEL, INC., Defendants, IOWA FRANCHISEE ASSOCIATION, Intervenor.	*	CIVIL NO. 4-92-70431 MEMORANDUM OPINION, RULINGS, ADJUDICATION, AND § 1292(b) CERTIFICATION

Plaintiff McDonald's Corporation ("McDonald's") and plaintiffs Holiday Inns Franchising, Inc. and Holiday Inns, Inc. (jointly referred to as "Holiday Inns") bring separate actions for declaratory judgment seeking determinations that the Iowa Franchise Act, House File 2362 (codified at Iowa Code ch. 523H) ("Act"), violates various provisions of the United States and Iowa constitutions.[1] McDonald's and Holiday Inns each move for partial summary judgment[2] on their claims that the Act violates federal and state Contract Clauses, U.S. Const. art. 1, § 10, cl. 1; Iowa Const. art. 1, § 21.[3] Defendants and intervenors in each case resist plaintiffs' motions. Defendant Terry Branstad in the Holiday Inns case, and intervenor State of Iowa in the McDonald's case, filed cross-motions for partial summary judgment. Plaintiffs resist the cross-motions. The court heard oral arguments, and all the motions are submitted.

SUMMARY JUDGMENT STANDARD

Rule 56 of the Federal Rules of Civil Procedure provides that summary judgment "shall be rendered forthwith if the

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[1] Plaintiffs claim, *inter alia*, impairment of contracts, denial of procedural and substantive due process, denial of equal protection, and discrimination against and undue burden on interstate commerce.

[2] Although McDonald's calls its motion a motion for summary judgment, it is more accurately called a motion for *partial* summary judgment because it is addressed only to the contract clause claims.

[3] On October 13, 1992, this court declined to consolidate these two cases, but because of the common legal issues in the motions, the court decided to hear the motions for summary judgment together.

pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). To preclude the entry of summary judgment, the nonmovant must make a sufficient showing on every essential element of its case for which it has the burden of proof at trial. *Celotex Corp v. Catrett*, 477 U.S. 317, 322-23 (1986); *Continental Grain Co. v. Frank Seitzinger Storage, Inc.*, 837 F.2d 836, 838 (8th Cir. 1988). The nonmoving party must go beyond the pleadings and by affidavits, or by the depositions, answers to interrogatories, and admissions on file, designate "specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e); *Celotex*, 477 U.S. at 324; *Johnson v. Schopf*, 669 F. Supp. 291, 295 (D. Minn. 1987). The quantum of proof that the nonmoving party must produce is not precisely measurable, but it must be "enough evidence so that a reasonable jury could return a verdict for the nonmovant." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 257 (1986); *Johnson*, 669 F. Supp. at 295-96.

On a motion for summary judgment, the court views all the facts in the light most favorable to the nonmoving party, and gives that party the benefit of all reasonable inferences that can be drawn from the facts. *United States v. City of Columbia, Mo.*, 914 F.2d 151, 153 (8th Cir. 1990); *Woodsmith Publishing Co. v. Meredith Corp.*, 904 F.2d 1244, 1247 (8th Cir. 1990).

BACKGROUND FACTS

The following facts are undisputed. From 1974 to 1982, McDonald's entered into license agreements with

Arch Madden for six McDonald's restaurants in central Iowa. The license agreements run for the following terms: (1) Ankeny, December 1974 to December 1994; (2) S.E. 14th, December 1974 to December 1994; (3) S.W. 9th, April 1979 to April 1999; (4) Altoona, February 1980 to February 2000; (5) Indianola, May 1981 to May 2001; and (6) E. 14th, November 1982 to October 2002. Defendant Steve Nelson acquired the rights to all of the above license agreements in July 1990 and March 1991; each franchise agreement has been assigned to defendant Tass Enterprises, Inc. (Nelson continues to be personally liable for the obligations).

Holiday Inns has two license agreements with defendant Omaha Hotel, Inc. One of the agreements, for a hotel in Davenport, is dated August 26, 1982, and has a termination date of August 8, 1996; the other agreement, dated July 2, 1984, is for a hotel in Council Bluffs, and has a termination date of August 14, 1995. Holiday Inns also has a license agreement with defendant John Q. Hammons for a hotel in Des Moines; that agreement is dated December 30, 1986, and has a termination date of December 29, 2006.

The Iowa Legislature convened the Franchise Regulation Interim Study Committee in 1991 to examine whether franchises in Iowa needed to be regulated, and if so, what that regulation would be. The Study Committee, composed of members of both the House and Senate, met on September 27, 1991, and November 1, 1991. The Committee heard testimony and received reports from franchisors, franchisees, experts, and other interested individuals and entities. In January 1992, the Committee issued its final report containing its recommendations for

legislation. After debate and compromise, the final version of the Act was passed on a 90 to 8 vote in the House and a 40 to 5 vote in the Senate. Governor Terry Branstad signed the bill on April 23, 1992. The Act became effective on July 1, 1992.[4]

INTRODUCTION

In their motions, McDonald's and Holiday Inns challenge, as violative of federal and state Contract Clauses, several sections of the Act in particular: Section 2, which makes the Act applicable to existing franchises operating in the state of Iowa; Section 5, governing transfers of franchises; Section 6, providing guidelines for new franchise encroachment on existing franchises; Section 7, regarding termination (only Holiday Inns specifically argues this section); and Section 8, on nonrenewal of franchises.

First, the court will set out the challenged statutory provisions, the contractual provisions alleged to be impaired, and plaintiffs' contentions as to the nature of the impairment. Next, the court will address two preliminary legal issues, ripeness and the Eleventh Amendment. The final section of the opinion will examine the issues presented under the Contract Clause.

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[4] Additional undisputed facts are discussed in other sections of the opinion.

STATUTORY AND CONTRACTUAL PROVISIONS

I. Transfer of Franchise

A. Section 5 of the Act

Section 5 provides that a franchisee may transfer the franchise if the transferee satisfies the "reasonable current qualifications" (qualifications based upon legitimate business reasons) of the franchisor for new franchisees. If the proposed transferee does not meet the franchisor's qualifications, the franchisor may refuse to permit the transfer, as long as the franchisor's refusal "is not arbitrary or capricious when compared to the actions of the franchisor in other similar circumstances." Iowa Code § 523H.5(1). Holiday Inns challenges subsections (1), (4), (5), and (13)(d), (e), and (f); McDonald's challenges subsections (4) and (13)(d), (f), and (g).

Subsection (4) states that a "franchisor shall not withhold consent to a franchisee making a public offering of the franchisee's securities without good cause, provided the franchisee or the owners of the franchise retain control of more than fifty percent of the voting power in the franchise."

Subsection (5) states that a "franchisee may transfer the franchisee's interest in the franchise, for the unexpired term of the franchise agreement, and a franchisor shall not require the franchisee or the transferee to enter into a new or different franchise agreement as a condition of the transfer."

Subsection (13) provides that certain occurrences shall not be considered transfers requiring the consent of the franchisor. These occurrences include a "transfer

within an existing ownership group of a franchise (13(d)); a "transfer of less than a controlling interest in the franchise to the franchisee's spouse or child or children (13(e)); and a "transfer of less than a controlling interest in the franchise of an employee stock ownership plan, or employee incentive plan (13(f)); all with the proviso that more than fifty percent of the entire franchise is held by those who meet the franchisor's reasonable current qualifications for franchisees. Under each of these subsections, if less than fifty percent of the franchise would be owned by persons who meet the franchisor's qualifications, "the franchisor may refuse to authorize the transfer," as long as the enforcement of the qualifications is not "arbitrary or capricious when compared to actions of the franchisor in other similar circumstances." The occurrence in 13(g), which is also an occurrence not considered a transfer requiring franchisor consent, is a

> grant or retention of a security interest in the franchised business or its assets, or an ownership interest in the franchisee, provided the security agreement establishes an obligation on the part of the secured party enforceable by the franchisor to give the franchisor notice of the secured party's intent to foreclose on the collateral simultaneously with notice to the franchisee, and a reasonable opportunity to redeem the interest of the secured party and recover the secured party's interest in the franchise or franchised business by paying the secured obligation.

B. McDonald's

Paragraph 15 of the McDonald's license agreement states that the licensee cannot "assign[ ] or otherwise

transfer[ ] in whole or in part" its interest in the license without the prior consent of the licensor. Subparagraphs (a) and (b) provide for assignment to family members in the case of death or permanent incapacity of the licensee, and assignment to wholly-owned corporations of the licensee. Subparagraph (c) provides the licensor with a first option to purchase the license after notice of licensee's intent to sell or transfer the license. Subparagraph (d) states that in addition to the assignments in subparagraphs (a) and (b), the licensee "shall not sell, transfer or assign this License to any person or persons without Licensor's prior written consent. Such consent shall not be arbitrarily withheld." Under subparagraph (d), the licensor considers several criteria in determining whether to grant consent, including work experience and aptitude, financial background, character, ability to devote full time to the restaurant, residence in locality of restaurant, equity interest in restaurant, conflicting interests, and other criteria and conditions then considered for applications for new licenses.

McDonald's argues that because the Act provides franchisees with a variety of transfer rights that pre-existing agreements, like those with defendants, do not allow, the Act is invalid as to pre-existing license agreements.

C. Holiday Inns

Section 12 of the Holiday Inns license agreement sets out many restrictions on transfer of the license. It states that any transfer "not specifically authorized pursuant to this section will be void and will also be a breach of this

agreement. The License may not be the subject of a security interest, lien, levy, attachment or execution." If the licensee wants to transfer the license, the "proposed transferee will, with Licensee's consent, apply for a new license agreement to replace the License for the unexpired term. Licensor will process the application in good faith and in accordance with procedures and criteria * * * then being applied by Licensor in issuing new licenses * * * ."

Section 12 of the agreement also contains provisions allowing transfer of equity interests with the licensor's consent with certain restrictions.

Holiday Inns argues that Section 5 of the Act directly conflicts with its requirement that transferees enter into new license agreements upon transfer, in part because the new agreements often require the transferee to perform reasonable quality upgrades. It also contends that the Act substantially restricts Holiday Inns' rights under existing agreements to control transfers and to select the best qualified individuals or entities as franchisees.

II. Encroachment

A. Section 6 of the Act

Section 6 states that notwithstanding the terms of an agreement or franchise,

> If a franchisor seeks to establish a new outlet, * * * within an unreasonable proximity of an existing franchisee, the existing franchisee, at the option of the franchisor, shall have either a right of first refusal with respect to the proposed

> new outlet, * * * or a right to compensation for market share diverted by the new outlet.

§ 523H.6(1). As applied to a food establishment or food service establishment franchisor, "unreasonable proximity" includes but is not limited to "the shortest distance as measured by the following methods": (a) a "three-mile radius, using a straight line measurement, from the center of an already existing franchise"; (b) a "circular radius, using a straight line measurement, from an existing franchise business which comprises a population of thirty thousand or greater."

Section 6(2) provides for a procedure for right of first refusal. First the parties "seek to establish a mutually agreeable price and terms." If they cannot reach agreement, each party appoints an independent appraiser. If the independent appraisers cannot agree, they name a third appraiser to determine the price and terms. The third appraiser's decision is final and binding, subject to judicial review under Iowa Code chapter 679A. The compensation for the diverted market share is determined by the same process. § 6(3).

B. McDonald's

Paragraph 2(a)(i) of the McDonald's agreement states that McDonald's grants a license to the licensee "to adopt and use the McDonald's System" in the restaurant at only the location specified in the agreement. The licensee acknowledges in paragraph 28(e) that the license establishes a restaurant at the location specified only, and "no 'exclusive,' 'protected' or other territorial rights in the contiguous market area of such Restaurant is hereby

granted or inferred." McDonald's argues that its experience shows that the absence of territorial or exclusive rights for the franchisee serves as an incentive to do more than bare-minimum compliance with the agreement and to avoid material breaches of the agreement.

Also, McDonald's has been planning to develop a new restaurant on Fleur Drive in Des Moines – a site that is within a three-mile radius of Nelson's existing S.W. 9th franchise location. Contrary to existing license agreements, under which McDonald's would be able to determine according to its own practices and policies who should operate the new franchise, the Act provides certain rights to existing franchisees in this situation. Therefore, McDonald's argues, the Act substantially impairs the license agreements.

C. Holiday Inns

Section 1 of the Holiday Inns agreement states that the license is nonexclusive, and "applies to the specified location and no other." It also provides that the agreement "does not limit Licensor's right to use or license the System or to engage in or license any business activity at any other location."

Holiday Inns argues that Section 6 of the Act imposes vague and undue restrictions on the establishment of new franchises or company-owned locations, undermining the concept of a nonexclusive license which is fundamental to its license agreements. It further asserts that the section apparently would apply to establishing franchises of different brands by the same franchisor (e.g., "Holiday Inn"

hotel and a "Holiday Inn Crowne Plaza"), thereby preventing it from serving different market segments of the consuming public in a given area.

III. Termination

A. Section 7 of the Act

Section 7(1) states that "a franchisor shall not terminate a franchise prior to the expiration of its term except for good cause," i.e. "cause based upon a legitimate business reason." Good cause includes a franchisee's failure to "comply with any material lawful requirement of the franchise agreement, provided that the termination by the franchisor is not arbitrary or capricious when compared to the actions of the franchisor in other similar circumstances."

Prior to good cause termination, the franchisor must provide the franchisee with "written notice stating the basis for the proposed termination." § 7(2). After service of the notice, the franchisee "shall have a reasonable period of time to cure the default," no less than 30 days or more than 90 days. *Id.*

Section 7(3) provides a list of situations in which "a franchisor may terminate a franchisee upon written notice and without an opportunity to cure," including: bankruptcy or insolvency of the franchisee or franchise business, voluntary abandonment by the franchisee, mutual agreement by the franchisor and franchisee to terminate, knowing material misrepresentation by the franchisee, the franchisee's repeated failure to comply

with the same material provision of the franchise agreement, lawful seizure or foreclosure by the government, conviction of felony or other criminal misconduct that materially affects the franchise, and operation of the franchise in a manner imminently endangering the public health and safety.

B. Holiday Inns

Section 14 of the Holiday Inns agreement provides that the license will terminate without notice on a specified date (usually for a 20-year term), subject to earlier termination in certain stated situations. Section 14 also provides for liquidated damages for premature termination.

Section 14(b) states that the licensor may terminate with notice if: "(i) the notice is mailed at least 30 days (or longer, if required by law) in advance of the termination date, (ii) the notice reasonably identifies one or more breaches of the Licensee's obligations, and (iii) the breach(es) is/are not fully remedied within the time period specified in the notice." If the notice is the second notice in 12 months about a certain violation for which the default was remedied the first time, the cure period will "if and to the extent permitted by law" be 10 days instead of 30.

The Licensor can immediately (or at the earliest time permitted by applicable law) terminate the licensee upon notice for the following reasons: licensee's insolvency or bankruptcy, licensee's loss of possession of the hotel, licensee's pursuit of a legal contest to the licensor's ownership of the system, a breach of Section 12 (transfer)

occurs, dissolution or liquidation proceedings on a corporate or partnership licensee (except for death of a partner), or "Licensee is, or is discovered to have been, convicted of a felony (or any other offense if it is likely to adversely reflect upon or affect the Hotel, the System or Licensor in any way)."

Holiday Inns argues that the Act's vague requirement of "good cause" should not replace its own well-defined and explicit provisions in its existing agreements. It also asserts that the Act would prohibit it from immediately terminating a franchisee in cases of egregious misconduct.

IV. Nonrenewal of a Franchise

A. Section 8 of the Act

A franchisor cannot refuse to renew a franchise unless: (1) the franchisor notifies the franchisee of its intent not to renew "at least six months prior to the expiration date of the franchise agreement"; *and* (2) good cause exists as defined in section 7 (and the refusal not to renew is not arbitrary or capricious compared to franchisor actions in similar circumstances), *or* the franchisor and franchisee agree not to renew the franchise (provided that the franchisor agrees not to enforce any covenant not to compete with the franchisor or its franchisees when the franchise expires), *or* the "franchisor completely withdraws from directly or indirectly distributing its products or services in the geographic market served by the franchisee" (provided that the franchisor agrees not to enforce any covenant not to compete with the franchisor or its franchisees).

B. McDonald's

All of the McDonald's license agreements at issue are for specific 20-year terms. The licensee acknowledges in paragraph 28(a) that the license is issued for the term stated "with no promise or representation as to the renewal of this License or the grant of a new License." McDonald's follows its own procedure for determining whether to re-write a license agreement, which it has found served as an incentive to "maximize franchisee performance and dedication." McDonald's Brief, p. 25. McDonald's argues that the Act, because it restricts the right of the franchisor to refuse to renew a franchise, contravenes the parties' existing agreements.

C. Holiday Inns

The Holiday Inns license agreements are for stated terms, and terminate without notice on the specified termination date. Section 15 of the agreements governs renewals. The licensee can apply for a "commitment to renew the License" during a certain year of the term (the 15th year for 20-year terms). The licensor promises to process the application in good faith and in accordance with procedures and criteria applicable to new license applications at the time. If the licensor approves the application, the parties sign two agreements: "A new license agreement covering the unexpired License Term under this agreement, and a commitment agreement to renew the License Term, upon expiration, for a specified time (up to 10 years) if Licensee fulfills specified upgrading and other requirements within a specified time."

Holiday Inns argues that the Act substantially impairs its agreements by effectively requiring Holiday Inns to grant a franchise of perpetual duration at the option of the franchisee, even though the franchisee paid only for a specified term. Holiday Inns also argues that the Section 6 of the Act disserves the public by preventing Holiday Inns from replacing marginal hotel operators at the end of a term, and from responding to changing market conditions by replacing inappropriate hotel locations.

RIPENESS

Certain defendants and intervenors argue that the issues in these cases, at least as applied to plaintiffs' specific license agreements, are not ripe for judicial determination. To fit within the constitutional limit on federal court jurisdiction to "cases and controversies," U.S. Const. art. III, § 2, "the controversy must be definite and concrete and not of a hypothetical or abstract character." *Oil, Chemical & Atomic Workers Int'l Union, AFL-CIO v. Gillette Co.*, 905 F.2d 1176, 1177 (8th Cir. 1990); *see also Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-41 (1937). "The ripeness doctrine is invoked to determine whether a dispute has yet matured to a point that warrants decision. The determination is rested both on Article III concepts and on discretionary reasons of policy." *Automotive, Petroleum & Allied Indus. Employees Union, Local 618 v. Gelco Corp.*, 758 F.2d 1272, 1275 (8th Cir. 1985) (citation omitted). The "question of ripeness turns on 'the fitness of the issues for judicial decision' and 'the hardship to the parties of withholding court consideration.' " *Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev.*

Comm'n, 461 U.S. 190, 201 (1983); *see also Abbott Labs. v. Gardner*, 387 U.S. 136, 149 (1967), *overruled on other grounds, Califano v. Sanders*, 430 U.S. 99, 105 (1977); *Gelco Corp.*, 758 F.2d at 1275.

In determining whether the issues are fit for consideration, courts look at numerous factors, including the adverseness of the parties, whether the legal issues would be affected by further factual development, judicial efficiency, finality, and the likelihood that the asserted injury or anticipated events will occur. *See Allstate Ins. Co. v. Wayne County*, 760 F.2d 689, 696 (6th Cir. 1985) (citing various cases).

Here, the defendants and interveners are sufficiently adverse to plaintiffs; the parties are contesting vigorously the issue of the constitutionality of the Act as applied to existing license agreements between plaintiffs and defendants. Because plaintiffs request a declaration that the Act's provisions in and of themselves conflict with their rights under their license agreements, further factual development is unnecessary.

The anticipated events are likely to occur. Some of the license agreements are approaching their termination dates; this certainly implicates the termination and nonrenewal provisions of the Act. The encroachment provisions of the Act affect the parties to the agreements not only when the final steps are taken to acquire land for a new franchise within an "unreasonable proximity" to an existing franchisee, but also at the planning and development stages when a decision has to be made whether and where to open a new franchise. The transfer provisions

change the franchisor consent requirements and the conditions under which some transfers can occur. Although the parties could await a situation where a current franchisee attempts to transfer within the terms of the statute but in violation of the franchisee's license agreement, this court will be in no better position later than now to decide the question of whether the Act's transfer and other provisions unconstitutionally impair plaintiffs' contract rights. *Cf. Duke Power Co. v. Carolina Envtl. Study Group, Inc.*, 438 U.S. 59, 81 (1978); *Bob's Home Service, Inc. v. Warren County*, 755 F.2d 625, 628 (8th Cir. 1985). The issues, therefore, are fit for judicial decision.

Furthermore, the uncertainty of which provisions to follow – the Act's or the license agreements' – constitutes hardship to the parties if this court withholds consideration of the constitutional issues under the Contract Clause. Plaintiffs (and for that matter their franchisees) should not be forced to act at their peril before a determination of these issues. This court concludes that the constitutional issues presented under the Contract Clause are ripe for adjudication.

ELEVENTH AMENDMENT

Defendant Branstad in the Holiday Inns case and intervenor State of Iowa in the McDonald's case argue that "the Eleventh Amendment deprives this court of jurisdiction to issue declarative or injunctive relief against the state based on alleged violations of state law," citing *Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89 (1984). The Eleventh Amendment, however, is not implicated in these cases because neither McDonald's nor

Holiday Inns seeks relief against Branstad or the state (and in McDonald's the state is merely an intervenor, not a defendant). Rather, plaintiffs seek a declaration that the Act, as applicable to plaintiffs' existing license agreements with the franchisee defendants, is unconstitutional under the federal and state Contract Clauses. The Eleventh Amendment does not deprive this court of jurisdiction.

CONTRACT CLAUSE

The federal Contract Clause provides that "[n]o State shall * * * pass any * * * Law impairing the Obligation of Contracts * * * ." U.S. Const. art. 1, § 10, cl. 1. The Iowa Contract Clause[5] uses language substantially similar to the federal clause, and the constitutional analysis is substantially the same, *see Adair Benev. Soc. v. State, Ins. Div.*, 489 N.W.2d 1, 5 (Iowa 1992).

I. Substantial Impairment

The threshold inquiry under the Contract Clause is whether the Iowa Franchise Act "has, in fact, operated as a substantial impairment of a contractual relationship." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978); *see also Energy Reserves Group v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983).

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[5] "No * * * law impairing the obligation of contracts, shall ever be passed." Iowa Const. art. 1, § 21.

> The severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected. Total destruction of contractual expectations is not necessary for a finding of substantial impairment. On the other hand, state regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment.

Energy Reserves, 459 U.S. at 411 (citations omitted). Under this inquiry, the court must "identify the precise contractual right that has been impaired and the nature of the statutory impairment." *Keystone Bituminous Coal Ass'n v. DeBenedictus*, 480 U.S. 470, 504 (1987).

The undisputed facts in both cases' summary judgment records clearly establish that the parties executed the license agreements at issue with certain expectations, including that the agreements applied to only certain franchise locations and for certain terms (many for 20 years), restricted transfer rights, included certain provisions for early termination, did not promise renewal, and contained no territorial rights. For plaintiffs, these expectations played an integral role in the pricing of the licenses, and continue to be important in the successful operation of each franchise and in the operation of plaintiffs' respective franchising systems in general. Plaintiffs assert that the rights they retained in their license agreements operate as an incentive for franchisees to maximize their performance; allow plaintiffs to change with current market conditions; and serve the consuming public by maintaining adequate control over the quality of services provided under their licensed trademarks.

For these reasons, the court concludes that the Iowa Franchise Act materially changes the rights to which the parties agreed and for which they gave consideration. *Cf. Birkenwald Dist. Co. v. Heublein, Inc.*, 776 P.2d 721 (Wash. Ct. App. 1989); *Jacobsen v. Anheuser-Busch, Inc.*, 392 N.W.2d 868, 874 (Minn. 1986), *cert. denied*, 479 U.S. 1060 (1987); *Ward v. Chevron U.S.A. Inc.*, 598 P.2d 1027 (Ariz. Ct. App. 1979); *Globe Liquor Co. v. Four Roses Distillers Co.*, 281 A.2d 19 (Del.), *cert. denied*, 404 U.S. 873 (1971).

"In determining the extent of the impairment," the court must "consider whether the industry the complaining party has entered has been regulated in the past." *Energy Reserves*, 459 U.S. at 411 (citations omitted). The court believes that the "industries" involved in these cases are the hotel[6] and food service industries. *See, e.g., Exxon Corp. v. Eagerton*, 462 U.S. 176, 194-95 n.14 (1983) (oil industry); *Energy Reserves*, 459 U.S. at 413 (natural gas industry); *Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32, 38 (1940) (building and loan association "enterprise"). State regulation of the hotel and food service industries prior to the Iowa Franchise Act focused mainly on the delivery of services to the customer, including safety and health concerns, *see, e.g.*, Iowa Code chs. 137B (food service), 137C (hotel), and discrimination against employees or customers, *see* Iowa Code §§ 216.6, 216.7 (formerly §§ 601A.6, 601A.7). The Act, which focuses on the business relationships between franchisors and franchisees, is

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[6] The court uses the phrase "hotel industry" in a more generic sense to include hotels, motels, inns, and other similar travel accommodations.

much different from the type of regulation existing at the time the Act became effective.

Defendants and intervenors identify the relevant industry as the "franchise industry," and argue that plaintiffs reasonably could and should have expected that franchising in Iowa would be subject to additional regulation because of past regulation of certain franchise relationships in Iowa and in several other states. It is doubtful that franchising is an "industry" within the meaning of that word as used in *Energy Reserves* and other cases, or as defined generally.[7] The Court in *Allied Structural Steel*, however, when faced with a statute involving pension plan funding, considered whether the act "operate[d] in an *area* already subject to state regulation at the time the company's contractual obligations were originally undertaken," or whether it instead "invaded an *area* never before subject to regulation by the State." 438 U.S. at 250 (emphasis added). This court will therefore consider state regulation in the "area" of franchising at the time the agreements were executed.

Iowa's past regulation of franchising has been confined to franchises involving retailers of certain goods – motor vehicles, agricultural equipment, and moter fuel.

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[7] "Industry" is defined as "a department or branch of a craft, art, business, or manufacture" and "a group of productive or profit-making enterprises or organizations that have a similar technological structure of production and that produce or supply technically substitutable goods, services, or sources of income." *Webster's Third New International Dictionary* 1155-56 (Merriam-Webster Inc. 1986). Franchising, on the other hand, is a means by which certain business relationships within an industry, and across industries, are formed and implemented.

See Iowa Agricultural Equipment Dealership Agreements Act, ch. 322F (1990); Iowa Farm Implement & Motorcycle Franchises Act, ch. 322D (1985); Iowa Purchasing Fuel from Alternate Sources Act, ch. 323A (1980); Iowa Travel Trailer Dealers, Manufacturers & Distributors Act, ch. 322C (1979); Iowa Marketing & Distribution of Motor Fuel & Special Fuel Act, ch. 323 (1974); Iowa Motor Vehicle Franchisors Act, ch. 322A (1970). In contrast, the Iowa Franchise Act extends to all franchises except those already regulated by state law and those relating to "the sale of construction equipment, lawn or garden equipment, or real estate." § 523H.1(3)(c).

Defendants also point to other states' general franchise statutes. *See, e.g.*, Illinois Franchise Disclosure Act of 1987, Ill. Ann. Stat. ch. 121 1/2 ¶ 1701 *et seq.* (eff. 1/1/88); California Franchise Relations Act, Cal. Bus. & Prof. Code §§ 20000 *et seq.* (eff. 10/1/80; operative 1/1/81); Nebraska Franchise Practices Act, Neb. Rev. Stat. § 87-401 to 87-410 (1978); Arkansas Franchise Practices Act, §§ 4-72-201 *et seq.* (1977); Indiana Deceptive Franchise Practices, Ind. Code Ann. § 23-2-2.7-1 (1975); am. 1985, 1987); South Dakota Franchises for Brand-Name Goods & Services Act, S.D. Codified Laws Ann. §§ 37-5A-1 *et seq.* (1974); Michigan Franchise Investment Law, Mich. Comp. Laws Ann. § 445.1527 (1974; am. 1984); Wisconsin Dealership Practices Act, ch. 135 (1974); Minnesota Franchise Act, Minn. Stat. Ann. ch. 80C (1973; am. 1987); Virginia Retail Franchising Act, Va. Code Ann. §§ 13.1-557 *et seq.* (1972); Wisconsin Franchise Investment Law, Wisc. Stat. Ann. ch. 553 (1972); Washington Franchise Investment Protection Act. Wash. Rev. Code Ann. §§ 19.100.180 – 19.100.190 (eff. 1972; am. 1973, 1980, 1991);

New Jersey Franchise Practices Act, N.J. Stat. Ann. §§ 56:10-1 to 10-12 (1971). This court doubts that regulation in one state or even several states accurately forecasts what another state will regulate. Defendants assert that looking to regulation in other states is proper because the Court in *Energy Reserves* mentions by way of footnote that the natural gas industry is heavily regulated, citing regulation by a majority of states and the federal government. *See* 459 U.S. at 413 n.15. In the discussion about prior regulation in the body of the opinion, however, the Court looks at the nature of natural gas regulation in Kansas specifically. *Id.* at 413-14.

Even if this court did consider other states' legislation, it would not provide support to defendants: those statutes were not as comprehensive as the Iowa Act; most, if not all, were only prospective in nature (or have been applied as such); and most were enacted after the parties executed at least some of the McDonald's license agreements. Even at the time of execution of the Holiday Inns agreements in the 1980s and assignment of the McDonald's agreements in 1990 and 1991, only a minority of states had enacted general franchise regulation. Therefore, I conclude that prior regulation in Iowa and other states at the time of the execution and assignment of the license agreements was not sufficient to put plaintiffs on notice that they would be subject to later regulation of the type contained in the Act.

This court concludes that the retroactive application of Iowa Code §§ 523H.5(4), (5), (13)(d), (f), and (g); 523H.6; and 523H.8 to McDonald's license agreements, and §§ 523H.5(3), (4), (5), (13)(d), (e), and (f); 523H.6; 523H.7; and 523H.8 to Holiday Inns license agreements,

substantially impairs the parties' contractual rights in the agreements in existence at the time the Act became effective.

II. Public Purpose

If the Act constitutes a substantial impairment, the state of Iowa must then show a "significant and legitimate public purpose behind the regulation" to justify it, "such as the remedying of a broad and general social or economic problem." *Energy Reserves,* 459 U.S. at 411-12. "The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests." *Id.* at 412. The police power " 'is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals.' " *Allied Structural Steel,* 438 U.S. at 241 (quoting *Manigault v. Springs,* 199 U.S. 473, 480 (1905)).

Senator Mike Gronstal, president of the Iowa Senate and a member of the Study Committee, filed an affidavit which states the following. The Iowa Legislature, through the Study Committee, undertook significant study of franchising to determine the areas in which legislation might be appropriate. The Committee found that some franchisors have engaged in abusive and unfair practices in relation to their franchisees.[8] The Committee heard

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[8] For instance, one Iowa franchisee spoke of the franchisor forcing him to sign, by threat and intimidation, a significantly different agreement several years before the end of his existing

testimony that franchising is an important part of Iowa's economy, that franchising as a way of business has been growing; and that the unfair practices of some franchisors can harm Iowa franchises, consumers, and other businesses. On this basis, the Study Committee recommended legislation in several areas. The bill went through several drafts, with changes made after consultation with franchisors.

A review of the summary judgment record shows that the major purposes of the Act, as articulated by proponents during the hearings, were the equalization of bargaining power, the promotion of fair dealing, and the protection of franchisees from fraudulent and abusive practices by franchisors. Proponents also asserted that the government's role is to ensure a fair market and fair business practices between franchisees and franchisors. The Committee hearings in large part focused on specific instances of abuses in Iowa and nearby states by a few national franchisors.[9]

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agreement. *See* Statement of Fred Miller. A Kansas franchisee spoke of an incident allegedly constituting "tortious interference with business relationships" by the franchisor, but his franchise agreement prohibited him from suing the franchisor. *See* Statement of Joel Grodberg.

The court notes that plaintiffs were not identified as those franchisors who have engaged in abusive practices.

[9] The record indicates, however, that others who wanted to appear and present statements did not out of fear of repercussions by their franchisors. *See, e.g.*, Committee Minutes, Nov. 1, 1991, p. 10 (comment of Co-Chair Hansen); Statement of Bob Schlutz.

Additionally, some franchisees spoke against the bill, fearing its effect on the good relationships they have with their

An important factor in the cases that have upheld the validity of legislation challenged under the Contract Clause is that the laws "did not prescribe a rule limited in effect to contractual obligations or remedies, but instead imposed a generally applicable rule of conduct designed to advance 'a broad societal interest' * * * ." *Exxon,* 462 U.S. at 191 (citation omitted); *see also Ross v. City of Berkeley,* 655 F. Supp. 820, 832-33 (N.D. Cal. 1987). The Court in *Exxon* distinguished the laws described above from those held invalid in *United States Trust Co. v. New Jersey,* 431 U.S. 1 (1977), and *Allied Structural Steel,* which " 'directly adjusted the rights and responsibilities of contracting parties.' " *Exxon,* 462 U.S. at 192; *Ross,* 655 F. Supp. at 833.

Here, the articulated overall purpose of the Act is specifically to adjust the balance of power between contracting parties. Although defendants and intervenors urge that franchising is a growing practice and a growing part of the economy in Iowa and throughout the nation, that fact by itself does not supply a broad societal interest justifying the substantial impairment of *existing* contracts. Nor have defendants and intervenors identified any other broad societal interest that the Act furthers. The state asserts that the unfair practices of some franchisors can harm consumers and other businesses, but it has not

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franchisors and on the quality of the particular franchising systems in which they operate. Some speakers related the perceived burdens the regulation would place on large and small franchisors alike. A few speakers noted that the vast majority of franchisors operate in good faith.

described the harm sufficiently for purposes of Contract Clause analysis.

This court finds and concludes that the Act is not based on a significant and legitimate public purpose such as a "broad and general social or economic problem" sufficient to justify the substantial impairment that some of its provisions have on plaintiffs' license agreements in existence on the Act's effective date.[10] Analysis under the last step in Contract Clause analysis is therefore unnecessary, and plaintiffs' motions for summary judgment will be granted.

RULINGS AND ADJUDICATIONS

The motion for summary judgment by plaintiff McDonald's Corporation in Civ. No. 4-92-70301, filed on September 18, 1992, is GRANTED. The cross-motion for partial summary judgment by intervenor State of Iowa in Civ. No. 4-92-70301, filed on November 16, 1992, is DENIED.

The motion for partial summary judgment by plaintiffs Holiday Inns Franchising, Inc. and Holiday Inns, Inc. in Civ. No. 4-92-70431, filed on October 23, 1992, is GRANTED. The cross-motion for partial summary judgment by defendant Terry Branstad in Civ. No. 4-92-70431, filed on November 16, 1992, is DENIED.

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[10] This court, of course, expresses no opinion on the constitutionality of the Act as applied to contracts entered into or renewed *after* the effective date of the Act.

IT IS ADJUDICATED that Iowa Code sections 523H.5(4), (5), (13)(d), (f), and (g); 523H.6; and 523H.8 substantially impair, in violation of the Contract Clauses of the United States Constitution and the Iowa Constitution, plaintiff McDonald's contractual rights under its license agreements with defendants Steven Nelson and Tass Enterprises, Inc., described in the Background Facts section of this Memorandum Opinion.

IT IS FURTHER ADJUDICATED that Iowa Code sections 523H.5(1), (4), (5), (13)(d), (e), and (f); 523H.6; 523H.7; and 523H.8 substantially impair, in violation of the Contract Clauses of the United States Constitution and the Iowa Constitution, plaintiff Holiday Inns' contractual rights under its license agreements with defendants John Q. Hammons and Omaha Hotel, Inc., described in the Background Facts section of this Memorandum Opinion.

§ 1292(b) CERTIFICATION

Pursuant to 28 U.S.C. § 1292(b), I certify that I am of the opinion that the foregoing adjudications involve a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the adjudications may materially advance the ultimate termination of the litigation.

Dated this 14th day of May, 1993.

EXHIBIT C

523H.6 Transfer of Franchise.

1. A franchisee may transfer the franchised business and franchise to a transferee, provided that the transferee satisfies the reasonable current qualifications of the franchisor for new franchisees. For the purposes of this section, a reasonable current qualification for a new franchisee is a qualification based upon a legitimate business reason. If the proposed transferee does not meet the reasonable current qualifications of the franchisor, the franchisor may refuse to permit the transfer, provided that the refusal of the franchisor to consent to the transfer is not arbitrary or capricious when compared to the actions of the franchisor in other similar circumstances.

2. Except as otherwise provided in this section, a franchisor may exercise a right of first refusal contained in a franchise agreement after receipt of a proposal from the franchisee to transfer the franchise.

3. A franchisor may require as a condition of a transfer any of the following:

a. That the transferee successfully complete a reasonable training program.

b. That a reasonable transfer fee be paid to reimburse the franchisor for the franchisor's reasonable and actual expenses directly attributable to the transfer.

c. That the franchisee pay or make provision reasonably acceptable to the franchisor to pay any amount due the franchisor or the franchisor's affiliate.

4. A franchisor shall not withhold consent to a franchisee making a public offering of the franchisee's securities without good cause, provided the franchisee or the

owners of the franchise retain control of more than fifty percent of the voting power in the franchise.

5. A franchisee may transfer the franchisee's interest in the franchise, for the unexpired terms of the franchise agreement, and a franchisor shall not require the franchisee or the transferee to enter into a new or different franchise agreement as a condition of the transfer.

6. A franchisee shall give the franchisor no less than sixty days' written notice of a transfer which is subject to the provisions of this section, and on request from the franchisor shall provide in writing the ownership interests of all persons holding or claiming an equitable or beneficial interest in the franchise subsequent to the transfer or the franchisee, as appropriate. A franchisee shall not circumvent the intended effect of a contractual provision governing the transfer of the franchise or an interest in the franchise by means of a management agreement, lease, profit-sharing agreement, conditional assignment, or other similar device.

7. A franchisor shall not transfer its interest in a franchise unless the franchisor makes reasonable provision for the performance of the franchisor's obligations under the franchise agreement by the transferee. A franchisor shall provide the franchisee notice of a proposed transfer of the franchisor's interest in the franchise at the time the disclosure is required of the franchisor under applicable securities laws, if interests in the franchisor are publicly traded, or if not publicly traded, at the time such disclosure would be required if the interests in the franchisor were publicly traded.

8. A transfer by a franchisor is deemed to be approved sixty days after the franchisee submits the request for consent to the transfer unless the franchisor withholds consent to the transfer as evidenced in writing, specifying the reason or reasons for withholding the consent. The written notice must be delivered to the franchisee prior to the expiration of the sixty-day period. Any such notice is privileged and is not actionable based upon a claim of defamation.

9. A franchisor shall not discriminate against a proposed transferee of a franchise on the basis of race, color, national origin, sex, or physical handicap.

10. A franchisor, as a condition to a transfer of a franchise, shall not obligate a franchisee to undertake obligations or relinquish any rights unrelated to the franchise proposed to be transferred, or to enter into a release of claims broader than a similar release of claims by the franchisor against the franchisee which is entered into by the franchisor.

11. A franchisor, after a transfer of a franchise, shall not seek to enforce any covenant of the transferred franchise against the transferor which prohibits the transferor from engaging in any lawful occupation or enterprise. However, this subsection does not prohibit the franchisor from enforcing a contractual covenant against the transferor not to exploit the franchisor's trade secrets or intellectual property rights, unless otherwise agreed to by the parties.

12. For purposes of this section, "*transfer*" means any change in ownership or control of a franchise, franchised business, or a franchisee.

13. The following occurrences shall not be considered transfers requiring the consent of the franchisor under a franchise agreement, and shall not result in the imposition of any penalties or make applicable any right of first refusal by the franchisor:

a. The succession of ownership of a franchise upon the death or disability of a franchisee, or of an owner of a franchise, to the franchisee's spouse, child or children, or a partner of the franchisee unless the successor fails to meet the then current reasonable qualifications of the franchisor for franchisees and the enforcement of the reasonable current qualifications is not arbitrary or capricious when compared to actions of the franchisor in other similar circumstances.

b. The succession of a spouse, child, partner, or other owner as operating manager upon the death or disability of the operating manager, unless the successor fails to meet the then current reasonable qualifications of the franchisor for an operating manager, and enforcement of the reasonable current qualifications is not arbitrary or capricious when compared to actions of the franchisor in other similar circumstances.

c. Incorporation of a proprietorship franchisee, provided that such incorporation does not prohibit a franchisor from requiring a personal guaranty by the franchisee of obligations related to the franchise.

d. A transfer within an existing ownership group of a franchise provided that more than fifty percent of the franchise is held by persons who meet the franchisor's reasonable current qualifications for franchisees. If less than fifty percent of the franchise would be owned by

persons who meet the franchisor's reasonable current qualifications, the franchisor may refuse to authorize the transfer, provided that enforcement of the reasonable current qualifications is not arbitrary or capricious when compared to actions of the franchisor in other similar circumstances.

e. A transfer of less than a controlling interest in the franchise to the franchisee's spouse or child or children, provided that more than fifty percent of the entire franchise is held by those who meet the franchisor's reasonable current qualifications if less than fifty percent of the franchise would be owned by persons who meet the franchisor's reasonable current qualifications, the franchisor may refuse to authorize the transfer, provided that enforcement of the reasonable current qualifications is not arbitrary or capricious when compared to actions of the franchisor in other similar circumstances.

f. A transfer of less than a controlling interest in the franchise of an employee stock ownership plan, or employee incentive plan, provided that more than fifty percent of the entire franchise is held by those who meet the franchisor's reasonable current qualifications for franchises. If less than fifty percent would be owned by persons who meet the franchisor's reasonable current qualifications, the franchisor may refuse to authorize the transfer, provided that enforcement of its reasonable current qualifications is not arbitrary or capricious when compared to actions of the franchisor in other similar circumstances.

g. A grant or retention of a security interest in the franchised business or its assets, or an ownership interest

in the franchisee, provided the security agreement establishes an obligation on the part of the secured party enforceable by the franchisor to give the franchisor notice of the secured party's intent to foreclose on the collateral simultaneously with notice to the franchisee, and a reasonable opportunity to redeem the interests of the secured party and recover the secured party's interest in the franchise or franchised business by paying the secured obligation.

14. A franchisor shall not interfere or attempt to interfere with any disposition of an interest in a franchise or franchised business as described in subsection 13, paragraphs "*a*" through "*g*".

92 Acts, ch 1134, §5

623H.6 Encroachment.

1. Notwithstanding the terms, provisions, or conditions of an agreement or franchise, if a franchisor seeks to establish a new outlet, company-owned store, or carry-out store within an unreasonable proximity of an existing franchisee, the existing franchisee, at the option of the franchisor, shall have either a right of first refusal with respect to the proposed new outlet, company-owned store, or carry-out store or a right to compensation for market share diverted by the new outlet. For the purposes of this section, "*unreasonable proximity*" as applied to a food establishment franchisor or food service establishment franchisor, including outlets and carry-out stores as defined by section 137A.1, subsection 6, and

section 137B.2, subsection 6, includes but is not limited to the shortest distance as measured by the following methods:

a. A three-mile radius, using a straight line measurement, from the center of an already existing franchise.

b. A circular radius, using a straight line measurement, from an existing franchise business which comprises a population of thirty thousand or greater.

2. With respect to a right of first refusal, the parties shall in good faith seek to establish a mutually agreeable price and terms. If the parties are unable to agree, each party shall appoint an independent appraiser. If the independent appraisers are unable to agree upon a price and terms, the independent appraisers shall name a third appraiser to determine the price and terms upon which the right of final refusal may be exercised. The determination of the independent appraiser shall be final and binding, and subject to judicial review under chapter 679A.

If two or more existing franchises are located within an unreasonable proximity to the proposed outlet, the closest franchisee shall have the first right of first refusal, and if declined, the right of first refusal shall pass to the next closest franchisee.

3. If the franchisor does not offer a right of first refusal, the franchisor shall compensate existing franchisees for market share diverted by the opening of the new outlet. If the franchisor and existing franchisees cannot agree upon the proper amount of such compensation, each party shall appoint an independent appraiser. If the

independent appraisers are unable to agree, the independent appraisers shall appoint a third appraiser who shall establish the level of compensation. The determination of the independent appraiser shall be final and binding, and subject to judicial review under chapter 679A.

4. The court may grant a permanent or preliminary injunction to prevent injury or threatened injury from the violation or threatened violation of this section.

92 Acts, ch 1134, §6

523H.7 Termination.

1. Except as otherwise provided by this chapter, a franchisor shall not terminate a franchise prior to the expiration of its term except for good cause. For purposes of this section, *"good cause"* is cause based upon a legitimate business reason. *"Good cause"* includes the failure of the franchisee to comply with any material lawful requirement of the franchise agreement, provided that the termination by the franchisor is not arbitrary or capricious when compared to the actions of the franchisor in other similar circumstances.

2. Prior to termination of a franchise for good cause, a franchisor shall provide a franchisee with written notice stating the basis for the proposed termination. After service of written notice, the franchisee shall have a reasonable period of time to cure the default, which in no event shall be less than thirty days or more than ninety days.

3. Notwithstanding subsection 2, a franchisor may terminate a franchisee upon written notice and without an opportunity to cure if any of the following apply:

a. The franchisee or the business to which the franchise relates is declared bankrupt or judicially determined to be insolvent.

b. The franchisee voluntarily abandons the franchise by failing to operate the business for five consecutive business days during which the franchisee is required to operate the business under the terms of the franchise, or any shorter period after which it is not unreasonable under the facts and circumstances for the franchisor to conclude that the franchisee does not intend to continue to operate the franchise, unless the failure to operate is due to circumstances beyond the control of the franchisee.

c. The franchisor and franchisee agree in writing to terminate the franchise.

d. The franchisee knowingly makes any material misrepresentations or knowingly omits to state any material facts relating to the acquisition or ownership or operation of the franchise business.

e. The franchisee repeatedly fails to comply with the same material provision of a franchise agreement, when the enforcement of the material provision by the franchisor is not arbitrary or capricious when compared to the franchisor in other similar circumstances.

f. The franchised business or business premises of the franchisee are lawfully seized, taken over, or foreclosed by a government authority or official.

g. The franchisee is convicted of a felony or any other criminal misconduct which materially and adversely affects the operation, maintenance, or goodwill of the franchise in the relevant market.

h. The franchisee operates the franchised business in a manner that imminently endangers the public health and safety.

92 Acts, ch 1134, §7

523H.8 Nonrenewal of a franchise.

A franchisor shall not refuse to renew a franchise unless both of the following apply:

1. The franchisee has been notified of the franchisor's intent not to renew at least six months prior to the expiration date or any extension of the franchise agreement.

2. Any of the following circumstances exist:

a. Good cause exists as defined in section 523H.7, provided that the refusal of the franchisor to renew is not arbitrary or capricious when compared to the actions of the franchisor in other similar circumstances.

b. The franchisor and franchisee agree not to renew the franchise, provided that upon the expiration of the franchise, the franchisor agrees not to seek to enforce any covenant of the nonrenewed franchise not to compete with the franchisor or franchisees of the franchisor.

c. The franchisor completely withdraws from directly or indirectly distributing its products or services in the geographic market served by the franchisee, provided that upon expiration of the franchise, the franchisor agrees not to seek to enforce any covenant of the nonrenewed franchisee not to compete with the franchisor or franchisees of the franchisor.

92 Acts, ch 1134, §8